



THE CITY OF SAN DIEGO **MANAGER'S REPORT**

DATE ISSUED: June 2, 2004 **REPORT NO.** 04-112

ATTENTION: Honorable Mayor and City Council, Docket of June 8, 2004

SUBJECT: Wastewater Fees and Charges

REFERENCES: Summary of Revised Sewer Rates (Attachment A)

SUMMARY

Issue: Should the City Council adopt a resolution which would revise presently existing wastewater fees and charges to bring the City into full compliance with the ratesetting requirements of the State Water Resources Control Board?

Manager's Recommendation: Adopt the resolution.

Other Recommendations – Public Utilities Advisory Commission Resolution Number PUAC-2004-04, adopted April 19, 2004 (Attachment B)

Fiscal Impact – There would be no fiscal impact from the revisions to the wastewater fees and charges since they are designed to be revenue neutral in the aggregate.

BACKGROUND

Wastewater-Related Proposition 218 Issues

In November 1996, California voters adopted Proposition 218, the Right to Vote on Taxes Act, which added articles XIII C and XIII D to the California Constitution. Article XIII D of the state Constitution specifies various restrictions and requirements for assessments, fees, and charges that local governments impose on real property or on persons as an incident of property ownership. This initiative changed the way the public is notified of proposed fee increases. Specifically, it requires that notices be mailed to all property owners of record at least 45 days in advance of the date on which a proposed property related fee increase may be adopted. Consistent with current Proposition 218 case law, approximately 345,400 notices of today's

hearing were mailed to every affected property owner of record during the week of April 19, 2004.

The Wastewater System's user charge system may also have implications with respect to other issues under Article XIII B and Article XIII D of the Constitution of the State of California. Whether the Wastewater System's sewer service charges are property-related fees and charges for purposes of Article XIII D of the California Constitution has been the subject of considerable uncertainty. To the extent that the Wastewater System's sewer service charges are property-related fees and charges they must meet the requirements of Article XIII D of the California Constitution, including a proportionality requirement. The City's current rate structure allocates costs on the basis of total suspended solids and flow. Employing this methodology, the City believes its current sewer service charges meet that requirement.

SWRCB Grant And Loan Compliance Issues

The City has been an ongoing participant in the Federal Clean Water Grant program since the early 1970's, and in the State of California State Revolving Fund low-interest loan program ("SRF") since its inception, receiving 17 separate federal and state Clean Water Grants and a total of eight SRF loans. The value of these grants and loans currently aggregates to approximately \$266 million. As a condition to receipt of these Clean Water Grants and as a covenant in the SRF loan agreements, the City must implement and maintain an approved wastewater user charge system that meets certain requirements. Currently, the Wastewater System's retail user charge system has not been approved by the State and has been found not to be in compliance with these requirements. The City has received two letters, one dated November 26, 2003 and another dated March 17, 2004, from the State Water Resources Control Board (the "SWRCB"), which, collectively, require the City to provide the SWRCB with evidence of City Council approval of a SWRCB-approved retail user charge system by July 1, 2004, and to implement such a system for Fiscal Year 2004-2005. If the City does not bring the Wastewater System's user charge system into compliance, the City could be forced to repay the aggregate amount of the Clean Water Grants and repay the outstanding principal amount of the SRF loans.

The possibility that the City may fail to adopt a SWRCB-approved sewer rate structure by July 1, 2004 and may, as a result, be forced to return \$266 million in grant and loan funds which have already been spent, represents a major risk to the investment community. This risk, which was disclosed as a part of the City's annual financial market disclosures in March of 2004, adversely affects the credit quality of the Sewer Enterprise Fund, which is the source for repayment of bond debt used for wastewater system capital construction.

DISCUSSION

Revisions To Sewer Fees And Charges Pursuant To Requirements of the SWRCB

As a condition of eligibility to receive and retain both federal and state Clean Water Grants and State of California SRF loans, the City must implement and maintain an approved user charge system that conforms to the requirements of Clean Water Grant regulations for the useful life of the grant funded facilities and until such time as all SRF loans are discharged. These regulations generally require that, to receive approval, user charge systems must recover all costs of

operation and maintenance from system users on a basis proportionate to use. That is, users must pay for their use of the Wastewater System based on their relative contributions to overall system handling and processing requirements, measured in terms of factors such as flow volumes and solids and organics loadings. The SWRCB administers these regulations and must approve the Wastewater System's user charge system. Failure to implement and maintain an approved user charge system may result in a demand that Clean Water Grant monies received be repaid, accelerated repayment of SRF loans including the imposition of market-rate interest, and ineligibility for further participation in the program.

Currently, the City's municipal user charge system does not include any specific cost recovery component for organics. Pursuant to the general regulations and permits under which the Wastewater System operates, the Wastewater System must ensure that the wastewater discharged into the Pacific Ocean does not contain organic materials in excess of a certain level, which requires the Wastewater System to incur certain costs to comply with that limit. Since certain commercial and industrial customers of the Wastewater System discharge wastewater with relatively high concentrations of organic matter, it is the view of the SWRCB that, absent an organics component in the billing structure, residential customers and other commercial and industrial customers of the Wastewater System discharging lower levels of organics and other materials pay a disproportionately higher percentage of the overall costs of the Wastewater System than is appropriate.

Pursuant to the requirements of the SWRCB as outlined in its letter of March 17, 2004 (See Attachment C), the City must adopt a compliant, proportionate-to-use user charge system by July 1, 2004. In prior recognition of that obligation, the City initiated a cost-of-service study to develop a wastewater user charge system that would be acceptable to the SWRCB. In October 2003, the consulting engineering firm of Black & Veatch completed an update of a cost-of-service study (the "Study") initially prepared in 2001. Such studies are the vehicle by which system-wide costs are identified, allocated and apportioned to user classes and individual system users consistent with SWRCB approval guidelines. The Study, which detailed the proposed compliant wastewater user charge system, was transmitted by the Mayor and City Council to the City's Public Utilities Advisory Committee (the "PUAC") for review, public input and recommendations on October 20, 2003.

The Study contained several suggestions, including: 1.) that the City employ the SWRCB-approved functional-design cost allocation methodology, including the chemical oxygen demand (COD) organics parameter, to allocate costs to all City of San Diego user classes; 2.) that the City establish a uniform fixed monthly fee for all user classes; and 3.) that the City increase the single family residential billing cap from 10 to 14 HCF of winter months water use since this class generates higher flow volumes than previously assumed. It was determined that incorporating the COD parameter would result in a cost shift among some user classes. Specifically, costs would shift from the single family residential user class to commercial/industrial user classes which discharge larger amounts of organic material to the wastewater system.

Listed in Table 2 below, are the current and revised fees and charges:

TABLE 2: SEWER FEES AND CHARGES		
	<u>CURRENT</u>	<u>REVISED</u>
<u>Single-Family Residential</u>		
Base Fee	\$10.90	\$10.53
Rate per HCF *	\$3.625	\$2.563
<u>Multi-Family Residential</u>		
Base Fee	\$0.63	\$10.53
Rate per HCF	\$3.366	\$3.461
<u>Commercial/Industrial**</u>		
Base Fee	\$0.63	\$10.53
Unit Rates		
Flow (\$/HCF)	\$2.61	\$2.5613
TSS (\$/lb)	\$.54	\$0.3994
COD (\$/lb)	n/a	\$0.1436

* 1 HCF (Hundred Cubic Feet) = 748 gallons. These rates may change due to the Winter Months Water Usage Adjustment effective July 1, 2004.

** Commercial/Industrial customers with average flow < 25,000 gallons per day would be billed via a rate matrix based upon the unit rates shown.

The actual implementation of the revised fees and charges would occur in October 2004.

Future Cost Of Service Studies – Frequency and Rationale

Wastewater Cost of Service studies should be conducted periodically or when there are physical changes in the system or its operation that materially impact the allocation of operation, maintenance and replacement costs between each utility's applicable cost centers. For example, the City is currently conducting a pilot test of a new secondary treatment technology (biological aerated filtration) at the Point Loma Wastewater Treatment Facility which should be completed in approximately one year. If the results of this test are positive, leading to a change in the treatment process at Point Loma, the Wastewater Cost of Service study should be updated to reflect the changes in costs and their allocation to the flow, total suspended solids and chemical oxygen demand parameters that would result.

CONCLUSION

Adoption of the revisions to the existing sewer fees and charges will bring the City into full compliance with the ratesetting requirements of the SWRCB. This action would also eliminate the significant financial risk of possibly having to repay \$266 million in grants and low interest loans, which will improve the credit quality of the Sewer Enterprise Fund.

ALTERNATIVE

Do not approve the requested actions. This is not recommended due to the possibility that the City could be forced to repay the aggregate amount of the Clean Water Grants and the outstanding principal amount of the SRF loans. Moreover, failure to implement a system of wastewater fees and charges that is acceptable to the SWRCB will result in the City having to continue to disclose to the bond market that \$266 million in grants and loans are at risk until the matter is resolved.

Respectfully submitted,

RICHARD MENDES
Deputy City Manager

KAHLIE/CR

Attachments: [A. Summary of Revised Sewer Rates](#)
[B. Public Utilities Advisory Commission Resolution Number PUAC-2004-04](#)
[C. State Water Resources Control Board letter dated March 17, 2004](#)